

**REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND
PERFORMANCE INFORMATION OF EDUMBE MUNICIPALITY FOR THE YEAR
ENDED 30 JUNE 2009**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the eDumbe Municipality which comprise the statement of financial position as at 30 June 2009, and the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 16 to 31.

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. Paragraph 11 *et seq.* of the Standard of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the eDumbe municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

Basis for disclaimer of opinion

Payables

5. The valuation of payables is stated at R19,00 million in note 4 to the financial statements. This balance included unsupported suspense accounts of R8,92 million and other payables of R2,30 million as well as incorrectly classified indigent debtor balances of R7,78 million. The entity's records did not permit the application of alternative audit procedures regarding payables. Consequently, I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the existence, completeness, obligations and valuation of payables.

Value-added Taxation (VAT) payables

6. The municipality submitted incorrect and incomplete VAT 201 returns to the South African Revenue Services (SARS) throughout the financial year. The differences were noted when comparing the VAT 201 returns to the general ledger for each month. Consequently, the municipality has under-declared VAT by R6,11 million, resulting in an understatement of current liabilities and overstatement of expenditure in the financial statements. Moreover, the VAT consumers and VAT debtors accounts amounting to R362 092 and R56 369 respectively were not accounted for in the financial statements.
7. The municipality could not access its financial information systems during the period of the audit. Consequently, I was unable to obtain all the information and explanations I considered necessary to satisfy myself that VAT was correctly accounted for on exempt goods and services, receipts, overpayment of consumer debtors and insurance proceeds. Moreover, Output Vat under-declared was offset against Input Vat over-claimed, resulting in the incurring of interest and penalties of R63 549 by the municipality.

Cash and cash equivalents

8. I was unable to confirm the valuation, completeness and existence of cash and cash equivalents totalling R1,98 million as disclosed in note 12 to the financial statements. In this regard, the above balance included journals totalling R10,93 million for which no supporting records were maintained as these were unknown and were not approved by the municipality. Furthermore, the cash book closing balance amounting to R10,65 million for May 2009 was not carried forward as an opening balance in June 2009 resulting in an unexplained difference. In this regard, the municipality's records and systems did not permit the application of alternative audit procedures.

Receivables

9. The valuation, existence, completeness and rights of other debtors amounting to R6,59 million, as disclosed in note 10 to the financial statements could not be confirmed. In this regard, the above balance includes numerous suspense accounts as well other debtors, for which no supporting records, reconciliations and explanations could be provided. The municipality's records and systems did not permit the application of alternative audit procedures.

10. An assessment of the recoverability of consumer debtors revealed a history of non-payment and a council approved 50% rebate to all consumers who would pay or make arrangements to pay their service charges. Consequently, the provision for the write-down of consumer debtors totalling R7,27 million as disclosed in note 9 to the financial statements, is deemed to be understated and receivables overstated by R10,58 million, respectively.

Property, plant and equipment

11. The existence, completeness, rights and the valuation of the additions to property, plant and equipment amounting to R419 792 could not be confirmed. This is as a result of insufficient supporting documentation and/or explanations. In this regard, the municipality's records did not permit the application of alternative audit procedures.

Fruitless and wasteful expenditure

12. The municipality incurred interest and penalties charges totalling R63 549 for the late submission of VAT returns during the year under review. The late submissions of the returns were contrary to section 28(1) of the VAT Act, 1991 (Act No. 89 of 1991). Furthermore, no disclosure was made in the financial statements of the fruitless and wasteful expenditure incurred, as required by section 125(2)(d) of the MFMA.

Reserves

13. The "non-distributable reserve for unutilised capital receipts" with a balance of R6,00 million for the current year and a closing balance of R0 in the previous year was noted in the general ledger but could not be traced to the financial statements. Furthermore, the "non-distributable reserve for a bank account" with a balance of R3,74 million in the current year and a balance of R1,57 million in the prior year was reflected in the general ledger but could also not be traced to the financial statements. In this regard, no explanations and/or documentation in support of these amounts or transactions could be provided.

Revenue

14. I did not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness, occurrence and accuracy of an amount of R712 567, relating to traffic fines and licence fees that are included as part of the "Other services/levies" in the statement of financial performance. In this regard, no explanations, reconciliations and documentation could be provided in support of or for the differences noted. Moreover, the entity's records did not permit the application of alternative audit procedures.
15. Rental income was incorrectly allocated to other "Other services/levies" in the statement of financial performance instead of "rental income", resulting in an overstatement of the "Other services/levies" and understatement of "rental income" by R310 691, respectively.

16. Grant revenue was not recognised in the statement of financial performance and as disclosed in note 14 to the financial statements for conditional grant when the conditions thereof were met amounting to R2,31 million. Consequently, revenue has been understated and the operating deficit was overstated by the same amount.

Expenditure

17. A differences of R1,09 million was noted for general expenses as disclosed in the statement of financial performance amounting to R8,53 million when compared to the general ledger amount of R9,62 million. No explanations and/or documentation in support thereof could be produced on request.

Contingent liabilities

18. The municipality has omitted disclosure of contingent liabilities amounting to R1,64 million, which was confirmed by the council attorneys during the financial year. This is contrary to section 125(2)(c) of the MFMA, which requires disclosure of contingent liability in the financial statements.

Disclaimer of opinion

19. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

I draw attention to the following matters:

Basis of accounting and amendments to the applicable basis of accounting

20. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.
21. As set out in accounting policy note 1 of the municipality's financial statements, the National Treasury approved a deviation from the basis of accounting applicable to the municipality in terms of *General Notice 552 of 2007*, issued in *Government Gazette No. 30013 of 29 June 2007*.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

22. The municipality provided supplementary information in the Annexure E(1) and E(2) to the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1 *Presentation of Financial Statements*. The supplementary budget information and other supplementary information set out on pages 32 to 39 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly and I do not express an opinion thereon.

Non-compliance with applicable legislation

Municipal Finance Management Act

23. The 2007/2008 annual report was not submitted or tabled within seven months from year-end, as required by section 127 of the MFMA.
24. Reconciliations in respect of six control accounts were not performed on a monthly basis, as required by section 65(2)(j) of the MFMA.
25. The municipality's website was not updated with the required information, as required by section 75 of the MFMA.

Municipal Systems Act

26. Employment contracts did not include the details of duties and terms of renewal for the section 57 employees, as required by sections 57(3) and 57(6)(c) of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA), respectively. Furthermore, evidence was not submitted to indicate that these contracts were made public, as required by section 57(1)(b) of the MSA.

Governance framework

27. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

28. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. No.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
5.	Payables	5	5	2,3	1	1,3
6, 7.	Value-added Tax (VAT) payables	3,7		3,5	1	1
8.	Cash and cash equivalents		5	2,3		3
9, 10	Receivables	5	5	2,3	1	1,3
11.	Property, plant and equipment			3	1	1
12.	Fruitless and wasteful expenditure	3,7		3,5	1	1
13.	Reserves			3		1
14, 15, 16.	Revenue	3		3	1	1
17.	Expenditure	3		3	1	1
18.	Contingent liabilities	3		3	1	1

29. The municipality did not submit requested information and documentation of its financial affairs in the agreed upon timeframes. Moreover, it did not maintain effective, efficient and transparent systems of financial and risk management and internal control, during the year under review.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward	7

system.	
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

30. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		<input type="checkbox"/>
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.		<input type="checkbox"/>
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	<input type="checkbox"/>	
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines, as set out in section 126 of the MFMA.	<input type="checkbox"/>	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.	<input type="checkbox"/>	
Development and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	<ul style="list-style-type: none"> The Municipality had an audit committee in operation throughout the financial year. 	<input type="checkbox"/>	
	<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 		<input type="checkbox"/>
	<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 		<input type="checkbox"/>
7.	Internal audit		
	<ul style="list-style-type: none"> The Municipality had an internal audit function in operation throughout the financial year. 	<input type="checkbox"/>	

No.	Matter	Y	N
	<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 		<input type="checkbox"/>
	<ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 		<input type="checkbox"/>
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		<input type="checkbox"/>
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		<input type="checkbox"/>
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		<input type="checkbox"/>
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used, as set out in section 62(1)(c)(i) of the MFMA.		<input type="checkbox"/>
12.	Delegations of responsibility are in place, as set out section 79 of the MFMA.		<input type="checkbox"/>
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.		<input type="checkbox"/>
14.	SCOPA resolutions have been substantially implemented.	<input type="checkbox"/>	
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		<input type="checkbox"/>
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		<input type="checkbox"/>
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the eDumbe Municipality against its mandate, predetermined objectives, outputs, indicators and targets, as set out in section 68 of the MFMA.	<input type="checkbox"/>	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	<input type="checkbox"/>	

31. The financial statements were not reviewed by the chief financial officer and the audit committee before submission for audit. The key officials were available to acknowledge requests during the audit period, however, requests for information and responses to exceptions were not honoured as per the agreed upon timeframes. Furthermore, the municipality did not comply with effective management of risk, good internal control and governance practices.

Investigations

32. During the period under review, the municipality discovered that monies receipted were not being banked. An investigation in this regard, is in progress.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

33. I was engaged to review the performance information.

The accounting officer's responsibility for the performance information

34. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

35. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

36. In terms of the foregoing my engagement included performing procedures of a review nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

37. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

Findings on performance information

No reporting of performance information

38. The eDumbe Municipality has not reported performance against predetermined objectives, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.

Existence and functioning of a performance audit committee

39. The eDumbe Municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations of 2001.

Internal auditing of performance measurements

40. The eDumbe Municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required by section 45 of the MSA.

APPRECIATION

41. The assistance rendered by the staff of the eDumbe Municipality during the audit is sincerely appreciated.

Pietermaritzburg

26 February 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

RESPONSES TO REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF EDUMBE MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009

RESPONSES ON THE FINANCIAL STATEMENTS

4. Payables

4. Response

The creditor balances have been reviewed and a report has been presented to Council in this regard.

After interrogation, it has been found that these amounts have been carried down from previous years and that there is no basis for carrying these amounts, and as Council has resolved per resolution 5/15/1/1 18 November 2009.

Corrective Action:- These amounts journal entries will be written off to rectify these amounts in the 2009/2010 financial year.

5. Value-added Taxation (VAT) payables

5. Response

The amounts reflected on the accounting records will require a review. The returns have been submitted on the basis that the amounts were allowable (per SARS).

Corrective Action: A thorough reconciliation of the VAT Accounts will be undertaken to establish the true VAT payable/receivable. The results of the review will be corrected in the 2009/2010 financial year.

6. Cash and cash equivalents

6. Response

Due to the problems experienced with the financial system, the cash book has now been reconciled to the Bank Statement and the reconciling items totalling R 10,93 million have to be actioned. This reconciled balance will be reflected in the carrying amounts on the new system as this was omitted on brought forward figures on the reports of the old system.

Corrective Action: Council has implemented a new financial system and the cash book/bank will be reconciled on a monthly basis and authorised by the CFO.

7. Receivables

7. Response

These amounts have been carried over from previous years. A review was done and Council resolved to write off R19 003 623 per resolution 5/15/1/1 18 November 2009

Corrective Action: A journal will be processed rectifying this query.

8. Property, plant and equipment

8. Response

It is envisaged that the full revaluation of all assets will be undertaken in the 2009/2010 financial year and that all assets will be verified and adjustments to the accounting records will be made to correctly reflect the carrying values of all the Municipality's assets. The assets register will be amended to include all disposals and additions. Included in the file containing the assets register will be the invoices and supporting documents for any additional assets purchased and these will be disclosed appropriately in the future.

9. Fruitless and wasteful expenditure

9. Response

This was an oversight, however any fruitless expenditure (should there be any instance:) will be reported to Council and be disclosed in the annual financial statements in the future.

10. Reserves

10. Response

It was reported to Audit that the differences are as a result of historical errors which were investigated and will be adjusted under authority of Council.

Corrective Action : These votes will be reviewed and the correct amounts will be carried as part of the take on balances in the Abakus system.

11. Revenue

11. Response :

This will be investigated and any discrepancies will be adjusted accordingly and reported to the Audit Committee/Council.

12. Moreover, the entity's records did not permit the application of alternative audit procedures.

13. Rental income was incorrectly allocated to other "Other services/levies" in the statement of financial performance instead of "rental income", resulting in an overstatement of the "Other services/levies" and understatement of "rental income" by R310 691, respectively.

12./13. Response:

In the old system this was not recorded under a separate line item.

Corrective Action: This is now been recorded separately in the new system.

14. Grant revenue was not recognised in the statement of financial performance and as disclosed in note 14 to the financial statements for conditional grant when the conditions thereof were met amounting to R2,31 million. Consequently, revenue has been understated and the operating deficit was overstated by the same amount.

14. Response

The disclosures will be corrected and the correct amounts will be recorded in the carrying amounts in the new system.

15. Expenditure

15. Response

It was reported to Audit that the basis for the preparation of the Annual Financial Statements was the Trial Balance and that no checks were undertaken to establish if the General Ledger had votes or values not consistent with the Trial Balance.

However this will be investigated and the differences will be adjusted when taking on the final balances in the new system.

16. Contingent liabilities

16. Response

At the time of preparing the Financial Statements, information pertaining to Contingent liabilities was requested for the Grant commitments only. It was unclear whether there were other potential liabilities for the Municipality/Council. These will be interrogated and will be disclosed should these liabilities not be concluded in the 2009/2010 financial year.

Corrective Action: Contingent liabilities will be confirmed with Council's attorney's in future.

22. Municipal Finance Management Act

22. Responses

Due to lack of staff capacity this was not performed in the past.

Corrective action : These control votes are now been reconciled on monthly basis.

23. .The municipality's website was not updated with the required information, as required by section 75 of the MFMA.

23. Responses :

As explained to the auditors part of this information had been updated and the Municipalities IT section is attending to the updating of all information that is required by section 75 of the MFMA.

24. Municipal Systems Act

24. Response

1. **Advertisement detail duties.**
2. **Section 57 Managers receive an all inclusive package.**
3. **Renewal is decided by Council. When Council decides to renew employment contract then Agreement is signed.**

27. Key governance responsibilities

27. (Responses/ Corrective Action are needed for the “No” answers in these paragraphs too.)

28. Investigations

(Responses/ Corrective Action are needed for this paragraph too.)

32. Findings on performance information

33. Existence and functioning of a performance audit committee

34. Internal auditing of performance measurements

32-34. Response

(to paragraphs 32-34)